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FOREST SERVICE TIMBER SALES PROGRAM

Questionable Need for Contract Term Extensions and Status of Efforts to Reduce Costs

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Mr. Chairman and Members of the Subcommittee:

I am pleased to provide this statement for the record on our observations on two distinct issues concerning the timber sales program of the Department of Agriculture's Forest Service. The first relates to work we did at the request of Representative Vic Fazio and involves a December 1990 regulation that allows for 1-year extensions in the length of timber sales contracts in response to drastic reductions in the prices for wood products. Representative Fazio has agreed to having us share with you our conclusions and recommendations on this work. As agreed with his office, this statement completes our work for him. The second issue, which we have examined at the request of this Subcommittee, is the status of efforts by the Forest Service to respond to a directive in its fiscal year 1991 appropriations act to reduce costs in its timber sales program.

In summary, regarding the first issue we believe that before issuing the final regulation in December 1990, the Forest Service did not thoroughly evaluate the costs and benefits to the government of allowing purchasers to postpone carrying out timber sales contracts and making payments to the federal government. Specifically,

-- the Forest Service did not evaluate the need for additional measures beyond its contract provision that automatically reduces the price agreed upon for timber if the prices of wood products drop sharply and

-- the contract extension provision may run counter to prior Forest Service reforms to discourage speculative bidding by allowing delays in performing contracts and making payments.

In addition, the Forest Service's regulation on extensions is inconsistent with the way other governmental agencies have handled this issue in the same geographic area. Neither of the other two federal agencies with timber sales programs in the West--the Department of the Interior's Bureau of Land Management (BLM) and the Bureau of Indian Affairs (BIA)--nor the states of California, Oregon, and Washington allow similar contract extensions, in part because they believe such extensions may encourage speculation among bidders.

Furthermore, in implementing the regulation, the Forest Service (1) used a formula with inappropriate data to reach a determination that prices for wood products from the Pacific Northwest had drastically declined and (2) questionably granted 1-year extensions for contracts that were awarded when prices were falling and that would have reflected this market trend.

Regarding the second issue, in October 1991 the Chief of the Forest Service issued an action plan to implement recommendations set forth in an April 1991 report by a Forest Service task force established to respond to the legislative directive that the agency reduce timber sales program costs. The Forest Service also has established a second task force to, among other things, explore additional opportunities to reduce timber sales program costs and enhance federal revenues. However, our work to date also has shown that, on a national basis, Forest Service costs to prepare and administer timber sales increased in 97 of 119 forests between fiscal years 1990 and 1991.

BACKGROUND ON THE REGULATION ALLOWING 1-YEAR EXTENSIONS IN TIMBER SALES CONTRACTS

During the late 1970s, a variety of factors, including an increased demand for timber products, resulted in aggressive bidding for federal timber. In anticipation of higher demand and higher lumber prices, and to maintain a supply of timber, purchasers bid increasingly higher prices for federal timber--especially in the West.

When the economy began to slow down in 1979 and housing starts fell from about 2 million units in 1978 to about 1 million units in 1981, lumber prices dropped to a point that prevented many timber purchasers from selling processed timber at prices that would allow the purchasers to recover their costs. As a result, many timber purchasers would have faced financial problems, including bankruptcy, if they were required to carry out existing contracts. To provide relief, the Congress passed the Federal Timber Contract Payment Modification Act in 1984, allowing holders of certain high-priced contracts to be released from them by paying a charge to the federal government.

Some purchasers took advantage of the act and, collectively, paid about $172 million to be released from more than 1,600 contracts totaling $2.5 billion. In addition, some purchasers defaulted on other contracts totaling about $647 million, for which the Forest Service assessed about $300 million in damages. As of April 1992, the Forest Service had collected about $40 million, or 13 percent of the damages assessed.

The Forest Service also has taken a series of actions designed to reduce defaults and better protect the government's interests if they occur. For example, since 1983 all Forest Service contracts of more than 12 months in the Pacific Northwest contain clauses that automatically reduce the price agreed upon for the timber if the prices of wood products drop sharply.

In November 1987, the Forest Service solicited public comments on a notice of proposed rulemaking published in the Federal Register to allow timber sales contracts to be extended 1 year or

more in response to drastic reductions in the prices of wood products. Citing the need to serve the overriding public interests of ensuring payments to the federal government and promoting stability in the forest products industry, the Forest Service published a final Market-Related Contract Term Addition regulation in December 1990. The regulation defines a drastic reduction in the prices of wood products as a regional decline in prices for two consecutive quarters below 80 percent of the region's average for the four highest quarters in the previous eight quarters.

During the last quarter of 1989 and the first quarter of 1990, bids by purchasers for Forest Service timber increased substantially, raising concern about a recurrence of defaults if the prices of wood products again declined. This decline began to occur toward the end of 1990, and an analysis by the Forest Service indicated that prices for Douglas fir wood products from the western side of the Pacific Northwest for the last quarter of 1990 and the first quarter of 1991 met the Forest Service's definition of a drastic reduction in wood product prices, triggering the regulation's provision to extend contracts.

In 1991, 67 of 214 purchasers applied for and were granted extensions on 432 of the 928 eligible timber sales contracts. Eight of these purchasers held contracts representing more than half of the over $1 billion original value of the contracts that were extended.

Appendix I contains the objectives, scope, and methodology of our review of the Market-Related Contract Term Addition regulation.

THE FOREST SERVICE DID NOT THOROUGHLY EVALUATE THE COSTS AND BENEFITS OF CONTRACT EXTENSIONS

We believe that the Forest Service did not adequately evaluate the costs and benefits to the government of allowing purchasers to postpone carrying out timber sales contracts and making payments to the federal government before issuing the agency's final regulation in December 1990 for the following reasons.

First, the Forest Service did not evaluate the need for measures beyond its contract provision that automatically reduces the price agreed upon for timber if the prices of wood products drop sharply. A November 1990 Department of Agriculture Office of General Counsel memorandum to the Chief of the Forest Service pointed out that neither the proposed regulation nor the supplementary information accompanying it discussed or analyzed the effect of this contract provision on purchasers' needs for additional relief in declining markets. This provision had not been in effect on the west side of the Pacific Northwest region during the market's decline between 1979 and 1982.

Second, the regulation appears to run counter to prior reforms by the Forest Service. The Federal Timber Contract Payment Modification Act of 1984 directed the Forest Service to implement procedures to discourage speculative bidding. In response to this problem, the Forest Service issued regulations to (1) shorten the terms of the contracts to reduce the purchasers' exposure to fluctuations in the market and (2) require midpoint payments. However, four of the public comments opposing the Forest Service's November 1987 proposed rulemaking to allow for 1-year contract extensions stated that this regulation would lead to speculative bidding by allowing purchasers to delay in performing contracts and paying for timber.

The Forest Service's regulation on extensions is also inconsistent with actions other governmental timber sellers have taken in the same geographic area. BLM and BIA, as well as the states of California, Oregon, and Washington, have not seen the need to provide such relief. Both BLM and BIA believe that fluctuations in the market should not cause contract extensions. Instead, BLM's policy is to stimulate purchasers' performance and discourage speculative bidding by keeping contract terms as short as practicable and by providing incentives for purchasers to fulfill contracts early. For instance, BLM retains cash deposits throughout most of a contract's term, encouraging prompt and orderly harvests and discouraging the stockpiling of timber under contract. Similarly, according to state officials, Washington and Oregon have no provisions for extending contracts on the basis of market-related conditions. In California, according to a state official, while purchasers may request contract extensions because of market-related reasons, the purchasers would be required to pay for the timber remaining on the contracts before the extensions were granted.

If the 67 purchasers who applied for and were granted 1-year extensions to their timber sales contracts would not have otherwise defaulted on these contracts, the extensions represent lost revenues to the government due to delayed payments. If any of these purchasers subsequently default on the contracts after the year extension, the government could incur additional costs. In this case, the government loses the opportunity to resubmit the timber for bid sooner. Conversely, if any of the purchasers successfully complete their contracts, who would have defaulted without the regulation, the government may benefit because it avoids the cost of defaults.

PROBLEMS OCCURRED IN IMPLEMENTING THE REGULATION

In implementing the regulation, the Forest Service used a formula with data that were not adjusted to account for seasonal fluctuations. We question the appropriateness of using these data to indicate market trends. If the Forest Service had used

seasonally adjusted data instead, the formula would not have indicated a drastic price reduction and would not have triggered a contract extension on the west side of the Pacific Northwest region.

In reaching a determination that a drastic reduction in wood product prices has occurred, the Forest Service uses the Bureau of Labor Statistics (BLS) indexes for all commodities and for those timber species representative of the wood products prevalent in a region or subregion. When these indexes are used, BLS advises that its seasonally adjusted data are preferred because they are designed to eliminate the effects of changes that normally occur at about the same time and in about the same magnitude each year, such as price movements resulting from normal weather patterns and regular production and marketing cycles.

The prices of building materials, including Douglas fir lumber, fluctuate not only with economic cycles of recession and prosperity through interest rate variations, but also seasonally. The prices usually increase in the spring and summer months and decrease during the winter months in reaction to the demands of the home building and construction industries. The Forest Service, however, used the BLS unadjusted Douglas fir index in determining that the decline in the prices of wood products from the western side of the Pacific Northwest for the last quarter of 1990 and the first quarter of 1991 met the Forest Service's definition of a drastic reduction in wood product prices. If the Forest Service had used BLS' seasonally adjusted Douglas fir producer price index instead, the regulation's provision allowing contract extensions would not have been triggered. Forest Service officials agreed that they should have used BLS' seasonally adjusted index and stated that they planned to study other formulas and indexes later this year.

The Forest Service also allowed contracts that already reflected falling wood product prices to be eligible for additional relief under the regulation's 1-year extension provision. Wood product prices began to drop toward the end of 1990, and bids during this time period would have reflected this decline. However, the Forest Service made all active timber sales contracts awarded on or prior to December 31, 1990, on the western side of the Pacific Northwest region (except those already extended under the Federal Timber Contract Payment Modification Act) eligible for 1-year extensions. We question the need for the Forest Service to allow all contracts to be eligible for extension.

STATUS OF THE FOREST SERVICE'S COST REDUCTION EFFORTS

I would like to turn now to the status of efforts by the Forest Service to achieve cost reductions in its timber sales

program. The Fiscal Year 1991 Interior Appropriations Act directed the Forest Service to reduce timber sales program costs.

A comparison of fiscal years 1990 and 1991 showed that timber sales preparation and administration costs per thousand board feet harvested increased for 97 of 119 forests, including 19 where these costs increased by more than 50 percent. (See app. II.) On a nationwide basis, Forest Service salary costs to prepare and administer timber sales increased by over 50 percent between fiscal years 1988 and 1991. Between fiscal years 1988 and 1991, timber sales program preparation and administration salary costs increased in every Forest Service region, ranging from a low of 26 percent to a high of 342 percent. However, during the same years the volume of timber offered by the Forest Service declined by 46 percent. (See app. III.)

To respond to the legislative directive to reduce timber sales program costs, the Chief of the Forest Service established a task force in September 1990 to review these costs, efficiencies, and organizational issues.[1] In its April 1991 report, the task force recommended both short- and long-term actions to improve efficiency in the program. In October 1991, the Chief of the Forest Service issued an action plan directing each national forest to review the timber sales program's (1) costs and revenues for fiscal year 1991; (2) staffing at all levels; and (3) allocations, planned and actual expenditures, and unit costs to increase efficiency while maintaining the necessary technical expertise to effectively carry out the program. In February 1992, the Chief established a second task force, comprising representatives from all nine Forest Service regions. Its purpose is to utilize the findings of the first task force to review every aspect of the timber sales program, including the optimal size of regional timber staffs in light of the reduced volume of timber offered for sale. The second task force held its first meeting in February 1992 and plans follow-up meetings in June and September 1992 to share initial findings.

In response to the request from this Subcommittee, we plan to continue our analysis of fiscal year 1991 costs and select individual forests for more detailed review. We believe that by analyzing such things as timber sales practices, accounting procedures, administrative processes, and the overall timber sales programs for selected forests, we will be able to determine why some forests have been successful in reducing costs while others have not. In addition, we will continue to follow efforts by the Forest Service to achieve cost reductions in its timber sales program.

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[1]The task force comprised Forest Service employees from headquarters, regional offices, and several national forests.

CONCLUSIONS AND RECOMMENDATIONS RELATING TO THE EXTENSION REGULATION

We believe that before issuing the final regulation, the Forest Service should have more thoroughly evaluated the costs and benefits of allowing purchasers to postpone the carrying out of timber sales contracts and payment requirements for 1 year. Therefore, we recommend that the Secretary of Agriculture direct the Chief of the Forest Service to reexamine the need for this regulation. The reexamination should evaluate the costs and benefits to the government of granting the current extensions. The evaluation should also consider the availability of the contract provision providing for automatic timber price reductions in the event of sharp drops in wood product prices.

If the Forest Service, in its reexamination finds that the regulation is justified, we recommend that the Secretary of Agriculture direct the Chief of the Forest Service to (1) stop using BLS' unadjusted indexes in reaching determinations that wood product prices have drastically declined and (2) make eligible only those contracts that do not already reflect falling prices.

OBJECTIVES, SCOPE, AND METHODOLOGY

In a letter dated March 7, 1991, and in a subsequent discussion, Representative Vic Fazio expressed concern about the Forest Service's Market-Related Contract Term Addition regulation which allows extensions of federal timber contracts in certain economic situations.

To address Representative Fazio's concerns regarding the regulation, we contacted Forest Service headquarters Timber Management Office staff and officials of the Pacific Northwest Regional Timber Management Office and reviewed pertinent documents. We also reviewed the public comments received in response to the publication of the proposed rulemaking in the Federal Register.

To determine whether other sellers of government timber in the Pacific Northwest allowed contract extensions, we interviewed timber staff officials of the Department of Interior's Bureau of Land Management timber management staff in the Oregon State Office and the Bureau of Indian Affairs timber sale forester in the Portland, Oregon, Area Office, and representatives with the timber sales programs in the California and Oregon State Departments of Forestry and the Washington State Department of Natural Resources.

To evaluate the use of the nonseasonally adjusted Douglas fir price index, we reviewed the Bureau of Labor Statistics' (BLS) Handbook of Methods, and interviewed a BLS headquarters official in the Office of Publications. We reviewed the Forest Service's calculations for triggering the regulation's provision allowing contract extensions and recalculated the trigger using seasonally adjusted price indexes. We did not review the methodology that the Forest Service used to develop the formula.

To determine the impact of the regulation, we obtained listings of the Forest Service timber sales contracts in western Oregon and Washington that were eligible for extensions under the regulation, and listings of those purchasers and contracts that were granted extensions.

Our review was performed between June 1991 and April 1992 in accordance with generally accepted government auditing standards.

TIMBER SALES PROGRAM PREPARATION AND ADMINISTRATION
UNIT COSTS PER THOUSAND BOARD FEET HARVESTED,
BY FOREST SERVICE REGION AND FOREST

National forest, by region	Average costs, by fiscal year 1990	Average costs, by fiscal year 1991
Region 1 (Northern)		
Beaverhead	$146.73	$126.02
Bitterroot	151.43	169.58
Panhandle	43.49	54.01
Clearwater	47.05	55.29
Custer	93.77	235.53
Deerlodge	74.57	175.19
Flathead	85.33	108.25
Gallatin	97.66	160.33
Helena	72.78	127.41
Kootenai	41.10	52.24
Lewis & Clark	96.24	97.55
Lolo	56.69	84.32
Nez Perce	47.23	48.37
Region's average	$ 58.41	$ 73.40
Region 2 (Rocky Mountain)		
Bighorn	$ 73.61	$ 71.97
Black Hills	28.11	33.63
GMUC	32.25	29.21
Medicine Bow	45.57	49.36
Nebraska	132.39	236.11
Rio Grande	42.67	43.17
Arapaho-Roosevelt	63.46	93.03
Routt	45.62	51.40
Pike-San Isabel	65.55	60.54
San Juan	39.66	41.47
Shoshone	51.16	72.16
White River	34.15	40.68
Region's average	$ 42.29	$ 48.67

National forest, by region	Average costs, by fiscal year 1990	1991
Region 3 (Southwestern)		
Apache-Sitgreaves	$ 46.14	$ 49.08
Carson	67.52	88.36
Cibola	100.48	94.24
Coconino	33.38	39.49
Coronado	221.88	363.86
Gila	76.36	108.27
Kaibab	52.13	74.91
Lincoln	109.67	142.50
Prescott	38.33	66.79
Santa Fe	70.94	105.85
Tonto	69.01	64.78
Region's average	$ 58.77	$ 69.55
Region 4 (Intermountain)		
Ashley	$ 48.37	$ 63.30
Boise	32.53	34.85
Bridger-Teton	72.57	63.96
Caribou	35.64	56.47
Challis	97.63	71.72
Dixie	44.50	62.21
Fishlake	58.40	67.87
Humboldt	40.52	34.38
Manti-LaSal	79.62	94.54
Payette	38.93	50.87
Salmon	66.75	67.12
Sawtooth	64.02	54.80
Targhee	31.95	38.45
Toiyabe	77.59	61.16
Uinta	39.25	35.11
Wasatch-Cache	45.47	47.14
Region's average	$ 47.26	$ 54.51
Region 5 (Pacific Southwest)		
Angeles	$386.67	$448.27
Cleveland	360.12	394.80
Eldorado	30.99	41.52
Inyo	68.14	62.14
Klamath	57.29	92.07
Lassen	32.69	37.97

National forest, by region	Average costs, by fiscal year 1990	1991
Los Padres	$184.95	$856.83
Mendocino	57.81	98.94
Modoc	35.71	51.53
Six Rivers	51.53	52.21
Plumas	45.83	54.89
San Bernardino	147.61	166.97
Sequoia	57.36	55.07
Shasta-Trinity	47.53	69.78
Sierra	37.39	64.48
Stanislaus	32.62	61.86
Tahoe	48.61	69.85
Lake Tahoe Basin	43.61	113.68
Region's average	$ 50.02	$ 69.62
Region 6 (Pacific Northwest)		
Colville	$ 45.10	$ 55.87
Deschutes	39.83	46.27
Fremont	40.15	48.53
Gifford Pinchot	40.67	43.86
Malheur	29.01	37.08
Mt. Baker-Snoqualmie	41.85	49.72
Mt. Hood	58.94	69.03
Ochoco	38.88	38.80
Okanogan	56.12	72.74
Olympic	80.88	102.66
Rogue River	48.47	63.55
Siskiyou	92.42	120.31
Siuslaw	33.84	43.92
Umatilla	40.82	49.07
Umpqua	26.49	38.36
Wallowa-Whitman	37.99	63.73
Wenatchee	43.27	54.12
Willamette	39.57	46.10
Winema	34.79	46.56
Region's average	$ 45.51	$ 54.87
Region 8 (Southern)		
Alabama	$ 26.81	$ 25.52
Daniel Boone	48.37	49.46
Chattahooche-Oconee	40.48	46.55
Cherokee	48.84	55.16

National forest, by region	Average costs, by fiscal year 1990	1991
Florida	$ 22.79	$ 27.64
Kisatchie	21.89	25.28
Mississippi	21.85	21.26
Geo. Washington	42.21	41.27
Ouachita	31.54	49.27
Ozark-St. Francis	37.09	54.89
N. Carolina	40.61	50.16
Marion-Sumter	15.07	30.07
Texas	34.85	40.36
Jefferson	45.13	48.55
Region's average	$ 30.05	$ 40.38
Region 9 (Eastern)		
Allegheny	$ 29.24	$ 38.47
Chequamegon	28.47	24.50
Chippewa	14.75	14.58
Green Mountain	79.12	81.66
Hiawatha	23.23	29.03
Huron Manistee	19.59	23.71
Mark Twain	31.68	37.40
Monongahela	44.75	40.59
Nicolet	20.96	31.65
Ottawa	23.37	30.77
Shawnee	123.54	188.35
Superior	21.40	21.51
Wayne-Hoosier	62.42	86.20
White Mountain	36.76	37.55
Region's average	$ 29.31	$ 33.72
Region 10 (Alaska)		
Tongass	$ 25.79	$ 32.50
Chugach	347.40	253.52
Region's average	$ 35.83	$ 48.79

TIMBER SALES PROGRAM PREPARATION AND ADMINISTRATION SALARIES AND TIMBER VOLUMES OFFERED, BY FOREST SERVICE REGION

Salaries in thousands, volumes in million board feet

	Amount, by fiscal year				Percent
	1988	1989	1990	1991	change
Region 1 (Northern)					
Volume offered	967.6	913.8	785.7	838.5	(13%)
Direct salaries	$14,930.3	$17,884.4	$21,845.6	$26,303.2	76%
Region 2 (Rocky Mountain)					
Volume offered	384.6	378.7	369.7	329.6	(14%)
Direct salaries	$5,813.8	$7,020.6	$7,336.8	$8,304.8	43%
Region 3 (Southwestern)					
Volume offered	372.6	401.8	328.8	279.5	(25%)
Direct salaries	$6,602.5	$8,780.6	$10,338.3	$10,941.7	66%
Region 4 (Intermountain)					
Volume offered	390.7	358.3	406.0	338.8	(13%)
Direct salaries	$6,737.8	$7,748.1	$9,598.4	$9,301.1	38%
Region 5 (Pacific Southwest)					
Volume offered	1,869.5	1,713.2	1,644.2	1,022.9	(45%)
Direct salaries	$27,946.4	$28,961.0	$32,525.8	$38,164.9	37%
Region 6 (Pacific Northwest)					
Volume offered	5,056.1	4,413.2	5,047.9	1,093.9	(78%)
Direct salaries	$48,670.7	$61,736.2	$74,532.2	$74,931.3	54%
Region 8 (Southern)					
Volume offered	1,210.4	1,205.0	1,363.0	1,129.4	(7%)
Direct salaries	$15,029.4	$18,084.7	$19,506.2	$21,694.5	44%

	Amount, by fiscal year 1988	1989	1990	1991	Percent change
Region 9 (Eastern)					
Volume offered	746.9	809.2	775.0	791.5	6%
Direct salaries	$9,863.4	$10,736.5	$10,868.8	$12,401.2	26%
Region 10 (Alaska)					
Volume offered	349.3	321.6	338.3	356.0	2%
Direct salaries	$771.7	$1,181.4	$3,274.3	$3,408.8	342%
Total					
Volume offered	11,347.7	10,514.8	11,058.6	6,180.1	(46%)
Direct salaries	$136,366.0	$162,133.5	$189,826.4	$205,451.5	51%

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